

**REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF NONGOMA MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Nongoma Municipality which comprise the balance sheet as at 30 June 2008, income statement, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages xx to xx.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The entity's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Basis for disclaimer of opinion

Employee benefits

5. The completeness, accuracy, occurrence, existence and valuation of the leave pay provision totalling R2 065 839 as disclosed in note 11 to the financial statements, as well as employee related costs could not be confirmed due to limitations placed on the scope of my work by the entity. In this regard, alternative audit procedures were not feasible because leave registers were not up to date and records supporting the balances could not be provided.

Payables

6. I was unable to confirm existence, completeness, rights and obligations and the valuation of payables stated at R2 778 416 in note 12 to the financial statements, in that, this balance included incorrectly classified general expenditure amounting to R264 121 and an unsupported VAT credit amount of R1 939 852. Moreover, the opening balance was misstated by R346 515. In this regard, alternative audit procedures were not feasible, as the necessary documentation and/or explanations were not provided on request.

Receivables

7. An assessment of the recoverability of consumer debtors revealed a history of non-payment. Consequently, the provision for the write-down of consumer debtors of R4 191 987, as disclosed in note 10 to the financial statements, is deemed to be understated and receivables is overstated by R10 911 725, respectively.
8. I was unable to confirm or satisfy myself by alternative audit procedures the valuation, completeness and existence of long-term debtors totalling R427 482, as disclosed in note 8 to the financial statements. In this regard, the above balance included land sales of R267 571 as well as vehicle loans of R159 911, for which no supporting records, reconciliations and explanations could be provided on request.
9. I was unable to confirm or satisfy myself by alternative audit procedures, the valuation, completeness and existence of the "Paye-As-You-Earn" debtor totalling R628 519 and VAT claims totalling to R1 818 164 as disclosed in note 10 to the financial statements, as no supporting records, reconciliations and explanations were provided during the audit.

Expenditure

10. The occurrence, completeness and accuracy of general expenditure transactions totalling R5 368 039 in respect of contributions to fixed assets and a payment of R73 729 relating to general expenses could not be confirmed, as a result of insufficient supporting documentation. In this regard, the municipality's records did not permit the application of alternative audit procedures and explanations considered necessary, could not be provided on request.

Investments

11. I was unable to confirm the valuation and completeness of long-term investments amounting to R530 508, as disclosed in note 7 to the financial statements. Moreover, the above balance also included an unsupported credit of R200 000 and the bank statement reflected an amount of R611 907. The entity's records did not permit the application of alternative audit procedures.

Revenue

12. No reconciliations were provided for the difference of R2 970 173 noted between the total grants as per DoRA allocation amounting to R33 106 673 and per the financial statements amounting to R30 136 500. The entity's records did not permit the application of alternative audit procedures. I was therefore unable to confirm the completeness, accuracy, and occurrence of grant income for the year under review.
13. I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness, occurrence and accuracy of an amount of R1 591 278, relating to other income that are included in the income statement. The entity's records did not permit the application of alternative audit procedures, as no explanations and/or documentation could be provided on request.

Appropriations

14. I was unable to confirm the completeness and accuracy of the accumulated surplus account included in note 17 to the financial statements. In this regard, the above balance included an adjustment to the opening balance of R5 435 330 as well as prior years' adjustments of R2 766 011. The entity's records did not permit the application of alternative audit procedures.

Unauthorised expenditure

15. The municipality has omitted disclosure of unauthorised expenditure of R1 640 898, which was incurred during the financial year. This is contrary to section 125(2)(d) of the MFMA, which requires disclosure of all unauthorised expenditure in the financial statements.

Disclaimer of opinion

16. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Nongoma Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matters:

Going concern

17. According to the financial statements (Chief Financial Officer's report) a net deficit of R2 481 151 was recorded for the year ended 30 June 2008. Moreover, at year-end the municipality's total liabilities exceeded its total assets by R2 747 457. Furthermore, the municipality has approached the Department of Local Government and Traditional Affairs to appoint an administrator as the municipality does not have cash resources to manage its daily operations.

Significant uncertainties

The following litigation matters are still in the process of being finalised; however, it has not been disclosed in the annual financial statements:

18. Eskom Holdings (Pty) Ltd instituted summons against the municipality in relation to a payment of R8 795 280 and interest on this amount at the prime rate plus 5% from October 2002, plus costs of the legal action.
19. An employee of the municipality referred a dispute to the CCMA and was successful. The municipality withheld an amount of R256 956. Should the claimant proceed against the municipality in this regard and is successful, the municipality faces financial risk amounting to R256 956, together with interest on this amount since 2005 and further legal costs until the matter is finalised.

20. The Municipal Councillors Pension Fund issued summons against the municipality in March 2008 claiming payment in the sum of R112 591 and interest on the aforesaid amount and an order directing the municipality to make payments of all amounts owing in respect of contributions payable under the Rules of the Pension Fund for the period January 2008 until the date of judgment.
21. An ex-employee has instituted action against the municipality for unpaid legal fees amounting to R177 049. The attorneys have sought an order for the Municipality to pay the above amount, all costs of the application on a scale between the attorney and client and requested that the municipality pay interest on R176 049 at 15.5% per annum from 13 July 2008 to date of final payment.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

22. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting items	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Employee benefits				✓	
Payables	✓		✓	✓	
Receivables	✓		✓	✓	
Expenditure			✓	✓	
Investments			✓	✓	
Revenue			✓	✓	
Appropriations	✓			✓	✓
Unauthorised expenditure	✓			✓	✓

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Non-compliance with applicable legislation

Municipal Finance Management Act

23. The 2006-2007 annual report was not submitted and tabled before council within seven months from year-end, as required by section 127.
24. The municipality does not have a fraud prevention plan and a risk management policy, as required by section 62.
25. Quarterly reports on the implementation of the budget and the financial state of affairs of the municipality were not tabled before council, as required by section 52(d).
26. Staff benefits expenditure reports were not tabled before council, as required by section 66.
27. The council did not approve the First National Bank overdraft facility, as required by section 45(3).
28. There is no evidence that National Treasury was informed of the net overdrawn position, as required by section 70(2).

Municipal Systems Act

29. There was no employment contract in place for the Chief Financial Officer and Director of Technical Services, as required by section 57(a) of the Local Government: Municipal Systems Act, 2000 (Act No.32 of 2000).
30. There were no performance contracts for the Municipal Manager, Chief Financial Officer and Director of Administration Services, as required by section 57(b).
31. The performance management system was not implemented, as required by section 38.

Local Authorities Ordinance

32. A three percent contribution of annual revenue was not made to the Capital Development Fund, as required by section 103 of the Local Authorities Ordinance, 1974 (No. 25 of 1974) nor was there proof that an exemption from the contribution was obtained.

Matters of governance

33. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matters of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.	✓	
• The audit committee operates in accordance with approved, written terms of reference.		✓
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		✓

Matters of governance	Yes	No
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.	✓	
• The internal audit function operates in terms of an approved internal audit plan.		✓
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	✓	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		✓
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		✓
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
• The prior year's external audit recommendations have been substantially implemented.		✓
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.		✓
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		✓
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.		✓

Unaudited supplementary schedules

34. The supplementary information set out on pages XX to XX do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

35. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

36. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

37. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
38. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
39. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

Content of integrated development plan

40. The integrated development plan of the Nongoma Municipality for 2007-2008 did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by section 26(i) of the MSA.

Existence and functioning of a performance audit committee

41. The Nongoma Municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee, as required by paragraph 14(2)(a) of the Local Government: Municipal Planning and Performance Management Regulations of 2001, as published in *Government Gazette No. 28895 dated 31 May 2006*.

Internal auditing of performance measurements

42. The Nongoma Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required by section 45 of the MSA.

Performance information not received in time

43. The financial statements submitted for auditing did not include a report on the performance information of the municipality, as required by *General Notice 616* as published in *Government Gazette No. 31057 dated 15 May 2008*, read with section 46 of the MSA. Moreover, the performance information was still outstanding at date of this report.

OTHER REPORTS

Investigation

44. An investigation is being conducted into allegations of maladministration of the municipality's finances.

APPRECIATION

45. The assistance rendered by the staff of Nongoma Municipality during the audit is sincerely appreciated.

Pietermaritzburg

28 November 2008



A U D I T O R - G E N E R A L